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P 300955Z AUG 78
FM AMEMBASSY TOKYO
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INFO AMEMBASSY BONN
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USEEC

USOECN ALSO FOR EMBASSY

E.O. 11652: N/A
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SUBJECT: JAPANESE ECONOMIC OUTLOOK FOR 1978/79

REF: TOKYO 11621

1. SUMMARY: THIS CABLE UPDATES EMBASSY'S JUNE ECONOMIC ASSESSMENT AND EXTENDS THE FORECAST THROUGH THE END OF CALENDAR YEAR 1979. NEAR-TERM WE CONTINUE TO LOOK FOR REAL GROWTH IN THE 6 PCT RANGE. PROSPECTS FOR 1979 ARE NOT YET CLEARLY FOCUSED BUT OUR JUDGMENT IS THAT 5 1/2 - 6 1/2 PCT GROWTH WILL BRACKET THE LIKELY OUTCOME NEXT YEAR. TRADE FIGURES OF RECENT MONTHS INDICATE THAT J-CURVE EFFECTS FROM YEN APPRECIATION HAVE ABOUT RUN THEIR
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COURSE AND THAT VOLUME ADJUSTMENTS ARE NOW SIGNIFICANT AND INCREASING. BARRING EXCHANGE RATE SURPRISES, WE WOULD EXPECT THIS DEVELOPMENT TO STRENGTHEN IN COMING MONTHS, RESULTING IN A NARROWING OF THE CURRENT ACCOUNT SURPLUS.
END SUMMARY.

2. PERSPECTIVE: OUR OVERALL IMPRESSION IS THAT THE

JAPANESE ECONOMY IS IN THE PROCESS OF SHIFTING TOWARD DOMESTIC-LED GROWTH AS IT MUST IF THE EXTERNAL SURPLUS IS TO BE REDUCED. HOWEVER, THERE IS STILL ONLY SKETCHY EVIDENCE OF A RESURGENCE OF PRIVATE DOMESTIC DEMAND AND IT SEEMS LIKELY THAT CONTINUED SUBSTANTIAL FISCAL STIMULUS WILL BE REQUIRED THROUGH 1979 IF CORRECTION OF THE EXTERNAL IMBALANCE IS TO BE SUSTAINED WITHOUT A RELAPSE INTO STAGNATION. CONSIDERABLE PROGRESS APPEARS TO HAVE BEEN MADE OVER THE LAST SEVERAL QUARTERS TOWARD RE-ESTABLISHING BETTER FINANCIAL BALANCE IN BOTH THE CORPORATE AND HOUSEHOLD SECTORS AND THIS SHOULD SMOOTH THE PATH FOR CONTINUED STRUCTURAL ADJUSTMENT. YET THE CRITICAL PARAMETERS OF THE JAPANESE ECONOMIC STRUCTURE (SAVINGS RATES, INVESTMENT PATTERNS, IMPORT ELASTICITIES, BUDGET DEFICITS, ETC.) REMAIN HIGHLY SKEWED, MAKING IT DIFFICULT TO FORE-SEE SMOOTH, TROUBLE-FREE ADAPTATION TO DOMESTIC-LED GROWTH.

3. THE HEAVY PUBLIC COMMITMENT OF THE JAPANESE GOVT TO STRONG ECONOMIC GROWTH, TO SAY NOTHING OF THE DOMESTIC POLITICAL REQUIREMENT TO AVOID ECONOMIC DETERIORATION, GIVES US CONSIDERABLE CONFIDENCE MACRO-ECONOMIC POLICIES WILL CONTINUE TO SUPPORT THE ADJUSTMENT PROCESS. DESPITE THE FREQUENTLY EXPRESSED CONCERNS THE GOVT HAS ABOUT EXCESSIVE RELIANCE ON DEFICIT FINANCING, THERE HAVE BEEN CLEAR SIGNALS IN RECENT WEEKS THAT THE GOVT IS PREPARED

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BOTH TO BUTTRESS THE FISCAL STIMULUS ALREADY IN PLACE FOR JFY 78 AND EXTEND IT INTO JFY 79. INDICATIONS ARE THAT FISCAL MEASURES DESIGNED TO ADD ABOUT YEN 2.5 TRIL O DOMESTIC DEMAND WILL BE ANNOUNCED AT THE SEPT 2 MEETING OF ECONOMIC CABINET MINISTERS, AND WE HAVE BUILT THIS INTO OUR ESTIMATES. THE GUIDELINES FOR BUDGET REQUESTS FOR JFY 79 HAVE BEEN SET AT NOMINAL INCREASES OF 13 PCT, A LEVEL THAT SHOULD ACCOMMODATE SUBSTANTIAL REAL GROWTH IN PUBLIC SPENDING GIVEN STABLE INFLATION TRENDS. SEPARATELY THERE HAVE BEEN BROAD HINTS THAT MOF HOPES OF INTRODUCING A CONSUMPTION TAX HAVE BEEN ALLOWED TO SLIP TILL AT LEAST JFY 80. FOR THE LONGER HORIZON, A REVISED FIVE-YEAR ECONOMIC PLAN IS REPORTED TO BE UNDER DISCUSSION IN EPA THAT WOULD SPECIFICALLY ACKNOWLEDGE THE NEED FOR CONTINUED LARGE DEFICITS THRU JFY 79. ON THE OTHER HAND, RESISTANCE MAY BE STRONG TO FURTHER SUBSTANTIAL EASING OF MONETARY POLICY.

4. RECENT DEVELOPMENTS: WITH SECOND QUARTER GNP DATA UNAVAILABLE UNTIL LATER IN THE WEEK, NO SOLID BENCHMARK IS AVAILABLE TO ASSESS THE RECENT EVOLUTION OF THE JAPANESE ECONOMY. PRESS SPECULATION HAS IT THAT THE SECOND QUARTER

GROWTH WILL COME IN AT AROUND 4.0 PCT (SAAR) AFTER THE 10 PCT GROWTH RATE RECORDED IN THE FIRST QUARTER. THIS APPEARS TO BE A REASONABLE BALLPARK ESTIMATE. OTHER FRAGMENTARY EVIDENCE SUGGESTS THAT A STRONG PERFORMANCE OF FINAL DOMESTIC DEMAND WAS SUBSTANTIALLY OFFSET BY A DECLINE IN THE REAL NET EXTERNAL SURPLUS AND NEGATIVE OR MINIMAL INVENTORY ACCUMULATION.

5. RE-

TAIL SALES IN THE SECOND QUARTER (DEPARTMENT STORE SALES PLUS SUPERMARKET SALES) WERE UP 11.4 PCT OVER YEAR-EARLIER LEVELS, AN IMPROVEMENT ON THE GOOD 9.9 PCT GAIN IN

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THE FIRST QUARTER. IN ADDITION, DOMESTIC AUTO SALES WERE STRONG THROUGHOUT THE QUARTER. BANK LENDING FOR NEW HOUSING CONSTRUCTION PICKED UP IN THE SECOND QUARTER, INDICATING THAT THE PICKUP IN HOUSING ACTIVITY NOTED IN THE FIRST QUARTER CONTINUED INTO RECENT MONTHS. RECENT INVESTMENT SURVEYS HAVE REVISED UPWARD THEIR ESTIMATES OF JFY 78 PRIVATE INVESTMENT WITH THE LONG-TERM CREDIT BANK RECENTLY RAISING ITS FORECAST FROM 10.2 PCT (NOMINAL) TO 14.8 PCT. A RECENT EPA SURVEY GIVES A SIMILAR PICTURE WITH A NOTICEABLE MID-YEAR BULGE IN THE PLANS. MOST OF THE STRENGTH CONTINUES TO BE IN THE NONMANUFACTURING SECTOR, PARTICULARLY FOR ELECTRIC POWER PROJECTS. HOWEVER, THE RECENT SURVEYS POINT TO A LEVELING OFF OF

MANUFACTURING INVESTMENT COMPARED TO EARLIER ANTICIPATED REDUCTIONS. DISBURSEMENTS UNDER PUBLIC WORKS PROJECTS HAVE ACCELERATED IN RECENT MONTHS SUGGESTING THAT THE EARLY FAST PACE OF CONTRACTING SHOULD BE REFLECTED IN THE PUBLIC SECTOR CAPITAL INVESTMENT ACCOUNTS IN THE SECOND
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AND SUBSEQUENT QUARTERS.

6. THE FRAGMENTARY EVIDENCE ON SPENDING THUS INDICATES THAT FINAL DOMESTIC DEMAND PROBABLY HELD UP WELL IN THE SECOND QUARTER. HOWEVER, PRODUCTION FIGURES SHOW A MORE SUBDUED PATTERN, WITH INDUSTRIAL PRODUCTION UP A MODERATE 1.7 PCT AND SHIPMENTS RISING BY BUT 0.9 PCT. THE DIVERGENT TRENDS OF PRODUCTION AND SPENDING INDICATORS ARE REFLECTED IN THE INVENTORY INDEX WHICH DROPPED 1.7 PCT IN THE QUARTER. TRADE FIGURES ALSO POINT TO A SUBSTANTIAL CONTRACTION IN THE REAL NET EXTERNAL SURPLUS DURING THE SECOND QUARTER. IN YEN TERMS THE SURPLUS FELL 8 PCT, WITH MUCH OF THE DECLINE DUE TO A FALL-OFF IN EXPORT VOLUME OF NO LESS THAN 7 PCT, WHILE IMPORT VOLUME WAS UP SLIGHTLY. THE STRONG VOLUME MOVEMENTS COULD TRANSLATE INTO A REDUCTION IN THE REAL NET EXTERNAL SURPLUS OF MORE THAN 1 PCT OF GNP. (NOTE HOWEVER THAT THIS FIGURE PROBABLY OVERSTATES THE CONTRACTIONARY IMPACT ON THE ECONOMY. IMPORT PRICES IN YEN HAVE DROPPED SO SHARPLY THAT TOTAL SPENDING ON IMPORTS HAS FALLEN WHILE VOLUMES INCREASED.)

7. AT MID-YEAR, THEN, IT APPEARS, SUBJECT TO CONFIRMATION FROM THE SECOND QUARTER GNP DATA, THAT FINAL DOMESTIC DEMAND IS DEVELOPING SMOOTHLY BUT THAT OVERALL GROWTH FIGURES ARE LIKELY TO BE RETARDED BY WEAK STOCKBUILDING AND A TAPERING OFF OF THE LARGE NET EXTERNAL SURPLUS. WE SEE LITTLE EVIDENCE OF A REPEAT OF THE MID-YEAR GROWTH PATTERN OF THE LAST TWO YEARS WHEN STRONG GROWTH IN THE FIRST QUARTER PETERED OUT IN THE LATTER PART OF THE YEAR. IN THOSE TWO PREVIOUS CASES WEAK FINAL DEMAND LED TO INVOLUNTARY INVENTORY ACCUMULATION AND A SUBSEQUENT CORRECTION. NO SUCH INVENTORY CYCLE APPEARS TO BE DEVELOPING ON THE BASIS OF RECENT TRENDS. THE SOON-TO-BE-ANNOUNCED
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SUPPLEMENTARY BUDGET MEASURES, WHICH ARE GENERALLY EXPECTED TO ADD TO DOMESTIC DEMAND SLIGHTLY MORE THAN 1 PCT OF GNP, SHOULD REPLACE MUCH OF THE SLACK GENERATED FROM THE CONTRACTION OF NET REAL EXPORTS. AS A RESULT

ENOUGH MOMENTUM APPEARS TO BE AVAILABLE TO CARRY THE ECONOMY ALONG THE PATH WE SKETCHED IN JUNE.

8. TRADE FIGURES OF RECENT MONTHS INDICATE THAT THE BLOATED CURRENT ACCOUNT SURPLUS MAY HAVE PASSED ITS CREST AND UNDERLYING TRENDS POINT TOWARD AN EBBING OF THE SURPLUS IN COMING MONTHS. AS NOTED ABOVE, WHEN MEASURED IN YEN, THE CURRENT ACCOUNT SURPLUS DROPPED ABOUT 8 PCT IN THE SECOND QUARTER (TO YEN 1.1 TRIL) AND THE JULY SURPLUS WAS DOWN FROM THE SECOND QUARTER AVERAGE. PERHAPS MORE SIGNIFICANTLY FOR SOME PURPOSES, THE SECOND QUARTER ALSO SAW A SIMILAR PATTERN IN THE CURRENT ACCOUNT WHEN MEASURED IN DOLLARS, AS THE SURPLUS RECEDED TO \$5.1 BIL (S.A.) FROM \$5.5 BIL IN THE FIRST QUARTER. THE JULY SURPLUS OF \$1.4 BIL WAS ABOUT \$300 MIL LESS THAN THE MONTHLY AVERAGE IN THE SECOND QUARTER. OF PARTICULAR INTEREST, THE DOLLAR VALUE OF EXPORTS APPEARS TO HAVE STOPPED RISING DESPITE THE CONTINUED UPWARD PRESSURE ON DOLLAR EXPORT PRICES AS A RESULT OF YEN APPRECIATION. IN THE SECOND QUARTER, DOLLAR EXPORTS DIPPED FRACTIONALLY AND JULY DOLLAR EXPORTS EASED SLIGHTLY FROM THE SECOND QUARTER RATES. IMPORT VALUES IN DOLLARS SHOW A RISING TREND, WITH THE SECOND QUARTER TOTAL UP ABOUT 2 PCT FROM THE FIRST QUARTER AND JULY FIGURES RUNNING A LITTLE AHEAD OF SECOND QUARTER AVERAGES. GIVEN THE VERY STRONG TERMS OF TRADE GAINS RECORDED OVER THE LAST YEAR -- AND CONTINUING RIGHT THROUGH JULY -- THIS DEVELOPMENT OF DOLLAR TRADE FIGURES MUST BE JUDGED ENCOURAGING. AT THE RISK OF POSSIBLY BEING A LITTLE PREMATURE, IT APPEARS THAT

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THE J-CURVE EFFECTS MAY HAVE PLAYED THEMSELVES OUT.

9. AS WE NOTED IN OUR JUNE ASSESSMENT, THE TERMS OF TRADE GAINS THAT HAVE BEEN RECORDED IN THE WAKE OF THE RAPID YEN APPRECIATION HAVE BEEN REMARKABLE. (THE FOLLOWING IS BASED ON MEASURES OF DOLLAR PRICE MOVEMENTS. WE HAVE CONVERTED THE MOF SEASONALLY ADJUSTED, YEN-BASED UNIT VALUE INDEX, BASE 1975, INTO A DOLLAR INDEX BY USING AN INDEX OF EXCHANGE RATE MOVEMENTS; THE SAME PROCEDURE WAS APPLIED TO THE N.S.A. BOJ INDEX, BASE 1975. STATISTICAL QUIRKS BEDEVIL BOTH SERIES BUT TAKEN TOGETHER THEY APPEAR TO CLOSELY BRACKET TRUE TRENDS. SEE STATISTICAL NOTE AT END OF PAPER.) EXPORTERS HAVE CONTINUED TO RESIST EROSION OF YEN PROCEEDS BY RAPIDLY PASSING THROUGH THE EFFECTS OF YEN APPRECIATION TO HIGHER DOLLAR PRICES. EXPORT UNIT VALUES IN YEN WERE VIRTUALLY UNCHANGED IN JULY FROM THEIR JAN LEVEL. (THE BOJ INDEX SHOWS A 2 PCT DECLINE.) DOLLAR EXPORT UNIT VALUES, IN CONTRAST, HAVE
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BEEN PUSHED UP 18 PCT IN THE SIX MONTHS ENDING JULY (14 PCT ON BOJ DATA) AND ARE UP 25 PCT OVER YEAR-EARLIER LEVELS (22 PCT ON BOJ DATA). DOLLAR IMPORT PRICES HAVE BEEN MUCH MORE SUBDUED THOUGH A SLIGHT FIRMING CAN BE DETECTED IN RECENT MONTHS. THE UNIT VALUE SERIES SHOWS DOLLAR IMPORT PRICES UP 3 PCT IN JULY OVER YEAR-EARLIER LEVELS WHILE THE BOJ SERIES SHOWS A 4 PCT RISE. THESE PRICE MOVEMENTS TRANSLATE INTO YEAR-OVER-YEAR DOLLAR TERMS OF TRADE GAINS OF 21 PCT (MOF BASIS) OR 17 PCT (BOJ BASIS).

10. AS NOTED ABOVE TRADE VOLUMES NOW APPEAR TO BE ADJUSTING WITH EXPORT VOLUME SHOWING SIGNIFICANT REDUCTIONS SINCE THE FIRST QUARTER AND IMPORT VOLUME SHOWING SIGNS OF PERKING UP. THE SEASONALLY ADJUSTED QUANTUM INDEX SHOWS AN 8 PCT DROP IN THE SECOND QUARTER AND A FURTHER DROP IN JULY OF 4 PCT BELOW THE SECOND QUARTER AVERAGE. SEASONALLY ADJUSTED DATA FOR INDIVIDUAL CATEGORIES OF EXPORTS ARE GENERALLY NOT AVAILABLE, BUT MITI DATA INDICATE THAT IN THE SECOND QUARTER EXPORTS OF SHIPS, IRON AND STEEL, AND MACHINERY SHOWED PARTICULAR WEAKNESS. AUTO EXPORTS APPARENTLY SLOWED SOMEWHAT FROM A VERY STRONG FIRST QUARTER. IMPORT QUANTUM WAS UP ABOUT 2 PCT IN THE QUARTER, THOUGH DISTORTIONS IN OIL IMPORTS HAVE MADE IT DIFFICULT TO CONFIRM A DISTINCT TREND. BY SEVERAL ACCOUNTS MANUFAC-

TURED IMPORTS HAVE BEEN SHOWING A STEADILY RISING TREND OVER RECENT MONTHS.

11. FORWARD INDICATORS OF TRADE MOVEMENTS SHOW NO CLEAR TREND. DOLLAR EXPORT LETTERS OF CREDIT (S.A.) WHICH ARE THOUGHT TO LEAD EXPORTS BY 2-3 MONTHS WERE VIRTUALLY UNCHANGED BETWEEN APRIL AND JULY. DOLLAR LICENSED IMPORTS, WHICH ALSO LEAD CUSTOMS IMPORTS BY ONE OR TWO MONTHS HAVE
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SHOWN LITTLE MOVEMENT IN THE LAST FOUR MONTHS. STABLE DOLLAR VALUES OF IMPORTS AND EXPORTS WOULD, HOWEVER, IMPLY CONTINUED ADJUSTMENT OF IMPORT AND EXPORT VOLUMES IN THE NEXT COUPLE OF MONTHS.

12. ANECDOTAL EVIDENCE ABOUT PHYSICAL LEADING AND LAGGING, ALONG WITH THE FIRMER EVIDENCE OF CONTINUED INVENTORY ADJUSTMENT, SUGGEST THAT THE COMING MONTHS SHOULD SEE A CONTINUATION OF THE TRENDS NOTED SINCE THE FIRST QUARTER OF THIS YEAR. FOR THE LONGER TERM, THE CLEAR EVIDENCE THAT MAJOR PRICE ADJUSTMENTS HAVE ALREADY OCCURRED, AND THE STRONG POLICY COMMITMENT OF THE JAPANESE GOVT TO MAINTAIN A HIGH GROWTH RATE, LEAD US TO BE OPTIMISTIC THAT AN IMPROVING PAYMENTS PICTURE SHOULD BE EVIDENT OVER THE BALANCE OF 1978 AND INTO 1979.

13. THE FORECAST: PRIVATE CONSUMPTION: BASED ON TRENDS TO DATE, OUR JUNE ESTIMATE OF 5.5 PCT GAIN IN REAL CONSUMPTION DURING CY 78 STILL APPEARS ON TARGET. PROSPECTS FOR 1979 ARE LESS CLEAR BUT SOMETHING IN THE 6 PCT RANGE SEEMS LIKELY IF OVERALL GROWTH CONTINUES IN THE 6 PCT RANGE. A MORE STABLE INFLATION PATTERN DURING 1978 ALONG WITH BETTER OPERATING RESULTS IN THE CORPORATE SECTOR SHOULD SMOOTH THE WAGE SETTLEMENT PROCESS NEXT YEAR ALLOWING WORKERS TO ANTICIPATE STEADY REAL WAGE GAINS. WE WOULD EXPECT TOTAL REAL PERSONAL DISPOSABLE INCOME TO GROW IN LINE WITH REAL AGGREGATE GROWTH NEXT YEAR SO THAT ANY SLIPPAGE FROM PRESENT HIGH SAVINGS RATE WOULD PERMIT CONSUMPTION TO EXPAND A LITTLE FASTER THAN THE OVERALL ECONOMY. ON THE OTHER HAND, IT SEEMS UNLIKELY THAT RECENT VERY LOW RATES OF INFLATION CAN BE MAINTAINED.

14. PRIVATE INVESTMENT: BASED ON RECENT SURVEYS OF IN-

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VESTMENT PLANS, WE HAVE UPPED OUR FORECAST OF PRIVATE INVESTMENT FOR CY 78 TO 5 PCT. NONMANUFACTURING INVESTMENT HAS BEEN PARTICULARLY STRONG WITH THE AMBITIOUS TARGET FOR THE ELECTRIC POWER INDUSTRY OF YEN 3.2 TRIL NOMINAL FOR JFY 78 LIKELY TO COME VERY CLOSE TO BEING ACHIEVED. INVESTMENT IN THE SERVICE SECTOR IN SUCH AREAS AS HOTELS, RECREATION AND FOOD SERVICE HAS ALSO BEEN STRONG. MANUFACTURING INVESTMENT ALSO IS REPORTED TO BE DOING A LITTLE BETTER THAN EARLIER EXPECTED WITH SPINOFFS FROM STRONG PUBLIC WORKS SPENDING AND A PICKUP IN THE ENGINEERING SECTOR. THE HEAVY INDUSTRIAL SECTOR CONTINUES TO RETRENCH BUT SHOULD STOP REDUCING ITS INVESTMENT BY NEXT YEAR. FOR CY 79 IT APPEARS THAT INVESTMENT IN THE ELECTRIC POWER INDUSTRY WILL AGAIN DOMINATE PRIVATE CAPITAL INVESTMENT. FUTURE CAPACITY REQUIREMENTS WOULD IN ANY CASE PROBABLY RESULT IN STRONG INVESTMENT IN THIS AREA BUT MITI GUIDANCE HAS BEEN USED TO FORCE THE PACE. EARLY INDICATIONS ARE THAT MITI WILL REQUEST STILL
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HEAVIER INVESTMENT FOR JFY 79, BUT IT SEEMS UNLIKELY ANY SUBSTANTIAL IMPROVEMENT OVER 1978 LEVELS WILL BE POSSIBLE. OVERALL, THE COMBINATION OF GOOD PERFORMANCE IN THE NON-MANUFACTURING SECTOR AND FEWER NEGATIVES IN THE MANUFACTURING SECTOR SHOULD KEEP THE REAL GROWTH RATE FOR PLANT AND EQUIPMENT INVESTMENT AT ABOUT THE SAME RATE NEXT YEAR AS THIS.

15. HOUSING INVESTMENT: REDUCED INTEREST RATES AND STRONG SUPPORT FROM PUBLIC PROGRAMS SHOULD KEEP HOUSING INVESTMENT EXPANDING AT ABOUT AN 8 PCT RATE THROUGH CY 79, PARTICULARLY SINCE THE LEVEL OF NEW HOUSING STARTS IS STILL WELL BELOW ITS PEAK LEVELS.

16. GOVERNMENT CONSUMPTION: AS NOTED ABOVE, BUDGET REQUEST GUIDELINES FOR JFY 79 OF 13 PCT NOMINAL INCREASE SHOULD PERMIT RESPECTABLE GAINS IN REAL GOVT SPENDING OVER THE COMING YEAR. AS IN THE RECENT PAST, WE WOULD EXPECT THESE INCREASES TO BE BIASED TOWARD CAPITAL PROJECTS AND HAVE THUS ASSUMED A 6 PCT INCREASE IN GOVT CONSUMPTION IN CY 79 AFTER A 5.5 PCT GAIN IN CY 78.

17. GOVERNMENT INVESTMENT: FURTHER GROWTH IN PUBLIC INVESTMENT IN CY 79 IS LIKELY BUT THE RATE OF INCREASE IS LIKELY TO BE WELL OFF FROM THE 20 PCT EXPECTED THIS YEAR, EXPANDING PERHAPS ONLY HALF AS RAPIDLY.

18. STOCKBUILDING: A SUBSTANTIAL LIGHTENING OF INVENTORIES APPEARS TO HAVE BEEN ACCOMPLISHED IN THE LAST TWO QUARTERS AND MONTHLY PRODUCTION FIGURES INDICATE THE PROCESS CONTINUED INTO JULY. FIRMS HAVE TAKEN ADVANTAGE OF STRONGER DOMESTIC SALES TO WORK DOWN AN INVENTORY OVERHANG THAT HAS BEEN A CONTINUING DRAG ON ECONOMIC ACTIVITY. IT
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IS DIFFICULT TO FORESEE ANY SUBSTANTIAL REBOUND IN STOCKBUILDING OVER THE FORECAST PERIOD, BUT AN END TO THE HOLD-DOWN ON STOCKBUILDING AND A GRADUAL RESUMPTION OF INVENTORY ACCUMULATION IN LINE WITH THE TREND OF FINAL DEMAND SHOULD BE EXPECTED. THIS PATTERN WOULD TRANSLATE INTO A DRAG ON GNP GROWTH THROUGH THE MIDDLE OF 1978 FOLLOWED BY A POSITIVE CONTRIBUTION TO GROWTH IN SUBSEQUENT QUARTERS.

19. EXTERNAL SECTOR: YEAR-OVER-YEAR WE NOW EXPECT THE REAL NET EXTERNAL SURPLUS IN CY 78 TO DECLINE SLIGHTLY. THE QUARTERLY PATTERN IS LIKELY TO BE FOR STEADILY SMALLER SURPLUSES OVER THE BALANCE OF THIS YEAR AFTER THE LARGE BULGE IN THE FIRST QUARTER. IMPORT VOLUME SHOULD GRADUALLY RISE WHILE EXPORT VOLUME RECEDES SLIGHTLY AFTER THE SHARP UP AND DOWN MOVEMENTS OF THE FIRST TWO QUARTERS OF 1978. WE WOULD EXPECT IMPORT VOLUME GROWTH IN 1979 TO OUTRUN A SMALL INCREASE IN REAL EXPORTS DURING 1979, RESULTING IN A CONTINUING CONTRACTION IN THE REAL NET EXTERNAL SURPLUS NEXT YEAR.

20. IN BALANCE OF PAYMENTS TERMS WE SEE -- BARRING

EXCHANGE RATE SURPRISES -- THE CONJUNCTION OF VOLUME AND PRICE MOVEMENTS COMBINING TO NARROW THE SURPLUS DURING THE FORECAST PERIOD. AS NOTED ABOVE, THERE IS ALREADY SOME EVIDENCE THAT J-CURVE EFFECTS ARE LARGELY SPENT. SOME REACTIONARY ADJUSTMENT TO THE RECENT DRAMATIC IMPROVEMENT IN JAPAN'S TERMS OF TRADE IS TO BE EXPECTED. EITHER THE FORCES THAT ALLOW JAPANESE EXPORTERS TO PUSH THROUGH 20 PLUS PCT FOREIGN CURRENCY PRICE INCREASES WILL COME TO BE AT LEAST PARTIALLY REFLECTED IN THE DOLLAR PRICES OF JAPAN'S IMPORTS OR SOME EROSION OF THOSE EXPORT PRICE HIKES WOULD SEEM TO BE IN ORDER.

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21. STATISTICAL NOTE: SINCE OUR JUNE ASSESSMENT MOF HAS REVISED ITS UNIT VALUE AND QUANTUM INDICES, UPDATING THE BASE TO 1975. THE RESULT IS TO ELIMINATE SOME BUT NOT ALL OF THE DIFFERENCES BETWEEN THE MOF UNIT VALUE SERIES AND THE BOJ PRICE INDICES. DIFFERENCES BETWEEN THE TWO PRICE SERIES CAN LEAD TO SLIGHTLY DIFFERENT ASSESSMENTS OF THE DERIVED VOLUME TRENDS.

22. TECHNICIANS WE HAVE TALKED TO AT MOF, BOJ AND EPA SUGGEST THE MOF UNIT VALUE/QUANTUM INDICES ARE THE MOST APPROPRIATE FOR ANALYZING TRADE VOLUME MOVEMENTS. THE MOF UNIT VALUE SERIES HAS THE VIRTUE OF BEING COMPREHEN-

SIVE (IT COVERS 90 PCT OF EXPORTS) AND CONTEMPORARY (USE OF A FISHER'S GEOMETRIC INDEX INCORPORATING CURRENT PERIOD WEIGHTS TAKES INTO ACCOUNT SHIFTING WEIGHTS.) ITS PRINCIPAL DRAWBACK IS THAT IT IS A UNIT VALUE INDEX WITH ALL THE ATTENDANT PROBLEMS OF NON-STANDARD DEFINITION OF

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UNITS MEASURED. MOF SPECIALIST THOUGHT THIS DRAWBACK WAS PARTIALLY MITIGATED BY THE LARGE NUMBER OF ITEMS SAMPLED, SOME 1150, WHICH RESULTED IN NARROW CLASSIFICATIONS OF PRODUCTS. SOME UPWARD BIAS TO THE UNIT VALUES WAS ACKNOWLEDGED GIVEN THE PUSH OF EXPORTERS TO SHIFT PRODUCTS UPSTREAM TOWARD ITEMS WITH HIGHER VALUE ADDED.

23. THE BOJ INDEX HAS THE VIRTUE OF BEING A TRUE PRICE INDEX WITH A CLEAR SPECIFICATION OF SAMPLED PRODUCTS. HOWEVER, ITS COVERAGE IS ONLY ABOUT 20 PCT THAT OF THE MOF INDEX. IN ADDITION, THE BOJ INDEX USES CONTRACT PRICES INSTEAD OF CUSTOMS CLEARANCE PRICES, WITH THE RESULT THAT THE PRICES THEY CALCULATE PROBABLY LEAD BY TWO OR THREE MONTHS THE PRICES ACTUALLY RECORDED IN THE BALANCE OF PAYMENTS DATA. BOJ SPECIALISTS ACKNOWLEDGED THAT PLANT EXPORTS WERE PROBABLY UNDERREPRESENTED IN THEIR INDEX AND THAT SHIPS WERE OVERREPRESENTED. THE RESULT MAY BE SOME DOWNWARD BIAS IN THE INDEX.

24. EPA SPECIALISTS TOLD US THAT IN CONSTRUCTING THE NATIONAL ACCOUNTS ESTIMATES OF MERCHANDISE EXPORTS IT USED THE EXPORT PRICES ESTIMATED BY BOJ. THE EPA PROCEDURE, HOWEVER, USES DIFFERENT WEIGHTS THAN BOJ IN CALCULATING ITS EXPORT DEFLATOR. EPA CONTRACTS A PAASCHE INDEX, RATHER THAN A LASPYRES INDEX, USING WEIGHTS AS CONTEMPORANEOUS AS IT CAN CALCULATE, WHICH IN PRACTICE FOR 1978 MEANS 1976 WEIGHTS. NO PARTICULAR REASONS OTHER THAN TRADITION WERE GIVEN FOR THE CHOICE OF THE BOJ EXPORT PRICES IN PREFERENCE TO THE MOF UNIT VALUE SERIES, ALTHOUGH EPA ANALYSTS WERE AWARE OF THE DIVERGENCES BETWEEN THE TWO SERIES.

THE TWO

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- FORECAST OF JAPANESE GNP
- (TRILLION YEN AT 1970 PRICES, PERCENT CHANGE)

- CY 77 CY 78/ CY 79/

PRIVATE CONSUMPTION 56.4 5 1/2 6

GOVT CONSUMPTION 7.7 5 1/2 6

GROSS DOMESTIC FIXED
CAPITAL FORMATION 32.7 11 1/4 7

- DWELLINGS 6.8 8 1/2 7 1/2

- PLANT AND EQUIPMENT 16.6 5.0 6

- GOVERNMENT 9.3 20.0 9

STOCKBUILDING (A) .9 (1/4) 1/2

EXTERNAL SURPLUS (A) 7.2 (1/2) (1/2)

GNP 105.0 6 6

NOTE A - INCREMENT EXPRESSED AS PCT OF PREVIOUS PERIOD GNP.
BALANCE OF PAYMENTS (\$ BIL)

CURRENT ACCOUNT 10.9 15 5

INFLATION (ANNUAL AVERAGE)

- CPI 8.0 5 6

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ACTION EA-12

INFO OCT-01 EUR-12 ISO-00 SP-02 ICA-11 AID-05 EB-08
NSC-05 SS-15 STR-07 OMB-01 CEA-01 CIAE-00 COME-00
FRB-03 INR-10 NSAE-00 XMB-02 OPIC-03 LAB-04
SIL-01 L-03 H-01 /107 W
-----017099 301137Z /12

P 300955Z AUG 78

FM AMEMBASSY TOKYO

TO SECSTATE WASHDC PRIORITY 0817

TREASURY/DEP WASHDC PRIORITY

INFO AMEMBASSY BONN

AMEMBASSY BRUSSELS

AMEMBASSY LONDON

AMEMBASSY PARIS
AMEMBASSY ROME

C O N F I D E N T I A L SECTION 06 OF 06 TOKYO 15699

- WPI 1.9 0 3
MANSFIELD

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 jan 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: DATA, ECONOMIC DEVELOPMENT
Control Number: n/a
Copy: SINGLE
Draft Date: 30 aug 1978
Decaption Date: 01 jan 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 20 Mar 2014
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
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Document Unique ID: 00
Drafter: n/a
Enclosure: DG ALTERED
Executive Order: GS
Errors: N/A
Expiration:
Film Number: D780354-0108
Format: TEL
From: TOKYO USEEC
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1978/newtext/t1978086/aaaaaesp.tel
Line Count: 663
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: fd028762-c288-dd11-92da-001cc4696bcc
Office: ACTION EA
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 13
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: n/a
Reference: 78 TOKYO 11621
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 04 may 2005
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 1725156
Secure: OPEN
Status: NATIVE
Subject: JAPANESE ECONOMIC OUTLOOK FOR 1978/79
TAGS: EFIN, ECON, JA
To: STATE TRSY
Type: TE
vdkgvwkey: odb://SAS/SAS.dbo.SAS_Docs/fd028762-c288-dd11-92da-001cc4696bcc
Review Markings:
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Declassified/Released
US Department of State
EO Systematic Review
20 Mar 2014
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